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FM AMEMBASSY ISLAMABAD
TO RUEHC/SECSTATE WASHDC 7471
INFO RHEFDIA/DIA WASHINGTON DC
RHEFSNG/HMSNG WASHINGTON DC
RHEFHOT/HOTR WASHINGTON DC//USDAO ISLAMABAD PK//
RUWSMXI/AMC INTEL CEN SCOTT AFB IL//INO/J2-J//
RUEPVAA/CDR JSOC FT BRAGG NC//J2/HSE//
RHMFISS/CDR USCENTCOM MACDILL AFB FL//CCJ2-JCH/HSE//
RHLFABN/CDR USESUCOM ABNCP VAIHINGEN GE//ECJ2/ECJ3/ECJ5-A//
RHMFISS/CDR USSOCOM MACDILL AFB FL//SOJ2/HSE//
RHMFIUU/CDR USTRANSCOM TCJ2 SCOTT AFB IL
RHMFISS/CDRUSAREUR HEIDELBERG GE//AEAGB-IAD//
RUEAIIA/CIA WASHINGTON DC//DDI/OEA//
RUEPVAA/COMJSOC FT BRAGG NC
RHMFIUU/COMSOCCENT MACDILL AFB FL//SOCJ2/HSE//
RHEFDIA/DIA WASHINGTON DC//DHO-3//
RHEFDIA/DIA WASHINGTON DC//MIO-4//
RUETIAA/DIRNSA FT GEORGE G MEADE MD//M112/S2132HT//
RUFOADA/JAC MOLESWORTH RAF MOLESWORTH UK
RUEKJCS/JOINT STAFF WASHINGTON DC//J2/J5-EUR//
RUZFNAI/NASIC WRIGHT PATTERSON AFB OH
RUZFNAI/NASIC WRIGHT PATTERSON AFB OH//DEKA/FCTP//
RUZFNAI/NASIC WRIGHT PATTERSON AFB OH//DXOA/TAAO//
RHEFNGB/NGIC INTEL OPS CHARLOTTESVILLE VA
RHEFNGB/NGIC INTEL OPS CHARLOTTESVILLE VA//IANG-CE-CM/IANG-GS-AA//
RHEFNGB/NGIC INTEL OPS CHARLOTTESVILLE VA//IANG/CE/CECM//
RUCXONI/ONI WASHINGTON DC//32/211//
RUEALGX/SAF WASHINGTON DC
RUEKJCS/SECDEF WASHINGTON DC//USDP-ISA-ADMIN//
RULWAAM/STRATCOM IDHS-90 OFFUTT AFB NE//J22123//
RUEPGAA/US SURVEY DIV SHAPE BE
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL
RUEHIL/USDAO ISLAMABAD PK
RUCQSAB/USSOCOM INTEL MACDILL AFB FL
RUEHLO/AMEMBASSY LONDON 2471
RUEHNE/AMEMBASSY NEW DELHI 6126
RUEHBUL/AMEMBASSY KABUL 1514
RUEHLH/AMCONSUL LAHORE 8545
RUEHKP/AMCONSUL KARACHI 2937
RUEHPW/AMCONSUL PESHAWAR 7602
RUEHRC/DEPT OF AGRICULTURE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDO/DEPT OF COMMERCE WASHDC
RHEBAAA/DEPT OF ENERGY WASHDC

UNCLAS SECTION 01 OF 04 ISLAMABAD 000410

SENSITIVE
SIPDIS

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SUBJ: BI-WEEKLY REPORT ON ECONOMIC ISSUES, FEBRUARY 3, 2010

TOP STORIES

1. (SBU) Ministry of Finance concerned over the declining tax-to-GDP ratio. On February 2 Business Recorder reported that, according to the Finance Ministry's 2009-2010 Fiscal Policy Statement, at the end of FY 09, Pakistan's tax-to-GDP ratio stood at 8.8 percent, with revenue collection totaling \$13.6 billion. This represents a 1 percent drop compared to the previous fiscal year. The government has set a target of \$16 billion for FY 10 tax collections. This would entail a 19.3 percent increase from FY09. Ministry of Finance officials said that the creation of the new Inland Revenue Service, Pakistan's IRS, would help streamline the process of introducing the value-added tax (VAT), a step towards increasing tax collection. (Comment: These revenue targets are ambitious given the current domestic and international economic environment and GOP's track

record. The GOP has yet to make much headway on the VAT, and the National Assembly has yet to pass the enabling legislation for it. End Comment.)

12. (SBU) National Assembly passes Anti-Money Laundering Bill (AML) 2009. On January 28 The Nation reported that the bill was approved by the National Assembly on January 27, but the Senate and President have yet to clear on it. Under the proposed legislation, violators could face fines of up to \$12,000 and jail terms of one to ten years. (Comment: The Financial Monitoring Unit (FMU), Pakistan's equivalent to a Financial Intelligence Unit (FIU), is already functioning and operating under the revised AML Ordinance of 2009, which closely meets international standards. The AML bill passed by the National Assembly is identical to the AML Ordinance President Zardari signed in November 2009. End Comment.)

13. (SBU) Government may cut the Public Sector Development Program (PSDP) by 50 percent. On January 26 Business Recorder reported that the Ministry of Finance may cut the \$4.97 billion currently allocated in the budget to fund 2010 PSDP projects in half. This proposed funding cut is due to the GOP's lack of liquidity attributed to an increase in defense spending and the delayed disbursement of Coalition Support Funds from the United States. (Comment: The PSDP includes substantial funds for infrastructural development. If implemented, this massive cut in development expenditures will serve as an additional deterrent for investors and slow economic growth. End Comment.)

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14. (SBU) State Bank of Pakistan (SBP) unveils FY10 monetary policy. On January 31 The News reported that, amidst fears of rising inflation and limited liquidity, the SBP is maintaining its policy rate at 12.5 percent. According to the Governor of the SBP, average inflation is expected to hover between 11 and 12 percent this fiscal year. SBP officials expressed hope that a decrease in Non-Performing Loans would strengthen the banks' confidence in the private sector and in turn increase private sector lending. (Comment: Increases in international commodity prices and the recent phase out of electricity subsidies could exacerbate inflation moving forward. End Comment)

15. (SBU) Lack of water may significantly reduce Punjab's next wheat harvest. On January 29 Business Recorder reported that farmers are increasingly concerned by the winter season dry spell. Punjab's wheat crop could be as much as 4 million tons below this year's target due to a lack of sufficient irrigation water. (Comment: The Indus River System Authority is expected to announce provincial water allotments in the coming weeks. Punjab government officials believe that demand for irrigation will exceed supply by at least 30 percent this season. End Comment.)

16. (SBU) Punjab may have trouble purchasing the 2010 wheat crop. On January 26, Dawn reported that the province borrowed over \$1.76 billion in 2009 to purchase wheat from local farmers at record high prices. Punjab has repaid only \$ 300 million of the debt accumulated from last year's purchases, jeopardizing the province's ability to secure financing for its 2010 purchases. Punjab's Food Department has already spent \$360 million on various subsidies this fiscal year. (Comment: It is the Punjab government's policy to purchase stocks of wheat for sale, at a subsidized rate, to flour mills annually. With mounting debt and limited income, Punjab may not be able to continue acting as a broker for the domestic wheat market. End Comment.)

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POWER & WATER
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17. (SBU) The Karachi Electric Supply Company (KESC) to offer up \$50 million worth of company shares. On January 22 Business Recorder reported that KESC struck this deal with the Asian Development Bank and the International Finance Corporation in an attempt to settle

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the \$324 million debt that it owes to both international financial institutions. (Comment: Contacts at the KESC confirmed that this deal is in the works, but still in its preliminary stages. End Comment.)

18. (SBU) 4Gas to set up floating LNG terminal at Port Qasim. On January 28 Business Recorder reported that the Minister for Petroleum and Natural Resources announced that the Economic Coordination Committee gave the green light to American-owned 4Gas to establish a floating LNG terminal at Port Qasim in Karachi. In five years, 4Gas will establish an \$800 million fixed terminal at the port to manage the long term import of LNG to Pakistan. The floating terminal's capacity is 3.5 million tons per annum of LNG, and the terminal is expected to be up and running by December 2011. (Comment: The GOP's approval was a direct result of the promise of OPIC financing for the project. The GOP has not yet approved the second, landed phase, of the project nor secured gas supplies for it. End Comment.)

19. (SBU) Cabinet rejects proposal to purchase 30 million energy saving bulbs. According to a January 22 article in The News, members of the Cabinet refused to sign off on this \$82 million project because of the exorbitant costs of the compact fluorescent light lamps. Under this 10-year joint Asian Development Bank/Agence Francaise de Development investment program, the GOP would distribute the bulbs to residential consumers free of charge, to replace existing incandescent bulbs. The expectation was that this initiative would help utility companies reduce peak demand by about 1,100 MW, and cut energy consumption by about 2,500 GWh per year. (Comment: Contacts at the ADB believe the project will still go forward in spite of the GOP's concerns. End Comment.)

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TRANSPORTATION
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10 (SBU) Another airline leaves Pakistan. On January 21, The News reported that, effective February 17, Singapore Airlines will suspend its flights from Karachi and Lahore. This decision comes in response to growing security concerns, which have scared away the small number of tourists and business travelers previously flying to Pakistan. Industry representatives indicated that the absence of a

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GOP policy to promote the aviation industry has exacerbated the problem. Currently, out of the 42 airports in country, 18 are functional and of these 9 are equipped to cater to international traffic. (Comment: Singapore Airlines officials confirmed the news and said that they are completely suspending their Pakistan operations as they no longer view the country as an attractive market. End Comment.)

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STOCK MARKET
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11. (SBU) Karachi Stock Exchange (KSE). The KSE 100 Index ended the week of January 29 at 9,632.76, down 1.5 percent from the previous week's close. Overall market capitalization decreased slightly from \$32.97 to \$32.45 billion, with net foreign portfolio investment outflow of \$1.32 million. Market activity was primarily driven by foreign participants, who invested because of attractive prices in the domestic market compared to other South Asian markets. The SBP's decision not to change its policy rate failed to buoy the market as most investors had already anticipated the move. (Comment: The stock market remained volatile due to the large sale of stocks in the regional markets. The depreciation of the Pakistani rupee also negatively affected the stock exchange's performance. End Comment.)

12. (SBU) Lahore Stock Exchange (LSE). According to Business Recorder, banking and oil stocks pulled the LSE down 2.45 percent in the second half of January, but the index continued to hover around

3,000. Volume and trading were relatively light.

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